

STATE OF NEW HAMPSHIRE PUBLIC UTILITIES COMMISSION			E X H I B I T S (continued)			Page 4
April 22, 2003 - 9:10 a.m. Concord, New Hampshire			DAY 1			
RE:	DT 02-110 VERIZON NEW HAMPSHIRE: Cost of Capital.		Exh. No.	Description:	Page #	
PRESENT:	Chairman Thomas B. Getz, Presiding Commissioner Susan S. Geiger Commissioner Nancy Brockway Christiane Mason, Clerk		29	BR/Conv. 1-55	22	
APPEARANCES:	Reptg. Verizon New Hampshire: Victor D. Del Vecchio, Esq.		30	BR/Conv. 2-2	22	
	Reptg. BayRing: Philip J. Macres, Esq.		31	BR/Conv. 2-7	22	
	Reptg. Conversent Communications of N.H.: Scott Sawyer, Esq.		32	Decision of Mass. DTE re: D.T.E 01-20 (07-11-02)	52	
	Reptg. MCI: Kenneth W. Salinger, Esq. Laura Gallo, Esq.		33	Item: TC RR 1 in Docket No. DT 01-006	55	
	Reptg. Residential Ratepayers: F. Anne Ross, Esq. Office of Consumer Advocate		34	NEWS Federal Communications Commission (02-20-03)	62	
	Reptg. PUC Staff: Barclay Jackson, Esq.		35	Worksheet Exhibit for DT 02-110 (CONFIDENTIAL)	76	
	Court Reporter: Steven E. Patnaude, CSR		36	Verizon's DS1 & DS3 UNE Policy	79	
			37	Direct Testimony of James A. Rothschild	120	
			38	Rebuttal Testimony of James A. Rothschild	120	
			39	Reply Testimony of James A. Rothschild	120	
			40	Updated JAR Exhibit 3, Sch. 1, Page 1	120	
			41	Pages 26 & 27 of Direct Test. of Mr. Rothschild (Confidential)	133	
			42	VZ-BR/Conv. 1-4	134	
			43	VZ-BR/Conv. 1-12	134	
			44	RESERVED (copy of article by Witness Rothschild)	158	
			45	Printouts of BayRing Web site	171	
			46	Printout of Conversent Communications' Web site	177	
			47	Direct Testimony of Stephen G. Hill	197	
			48	Verizon New Eng. Cash Flow Statement 1994-2001	210	

E X H I B I T S (continued)			P R O C E E D I N G S			Page 5
1	Direct Testimony of Dr. James H. Vander Weide	18	2	CHAIRMAN GETZ: Good morning. We will		
2	Sup. Direct Testimony of Dr. James Vander Weide	18	3	open the hearing in docket DT 02-110, verizon New Hampshire		
3	Rebuttal Testimony of Dr. James H. Vander Weide	18	4	cost of capital. On June 18, 2002, the Commission issued an		
4	BR/Conv. 1-1	22	5	order of notice opening this proceeding to determine the		
5	BR/Conv. 1-2	22	6	appropriate cost of capital for Verizon New Hampshire and to		
6	BR/Conv. 1-3	22	7	examine whether recurring TELRIC rates should be modified to		
			8	take into account a revised cost of capital. A prehearing		
			9	conference was held on July 12, 2002. Procedural orders		
			10	were subsequently issued on September 16 and November 27.		
			11	After a number of attempts to accommodate various scheduling		
			12	concerns, the hearing is beginning this morning as		
			13	scheduled.		
			14	Can we take appearances please.		
			15	MR. DEL VECCHIO: Good morning, Mr.		
			16	Chairman, Commissioner Geiger, Commissioner Brockway.		
			17	Victor Del Vecchio, representing Verizon New Hampshire.		
			18	And, with me at the front table this morning is Victor		
			19	DeSantis and Alan Cort.		
			20	CHAIRMAN GETZ: Good morning.		
			21	MR. MACRES: Good morning. My name is		
			22	Phil Macres. I'm with the law firm of Swidler, Berlin,		
			23	Shereff, Friedman. I'm here and I represent BayRing. With		
			24	me is our expert witness, Jim Rothschild.		

E X H I B I T S (continued)			P R O C E E D I N G S			Page 6
7	BR/Conv. 1-5	22	1	CHAIRMAN GETZ: Good morning.		
8	BR/Conv. 1-6	22	2	MR. SAWYER: Good morning, Mr. Chairman,		
9	BR/Conv. 1-7	22	3	Commissioners. I'm Scott Sawyer. I represent Conversent		
10	BR/Conv. 1-8	22	4	Communications of New Hampshire. And, Conversent is also		
11	BR/Conv. 1-10	22	5	jointly sponsoring the witness.		
12	BR/Conv. 1-11	22	6	CHAIRMAN GETZ: Good morning.		
13	BR/Conv. 1-13	22	7	MR. SALINGER: Good morning. I'm Ken		
14	BR/Conv. 1-19	22	8	Salinger, of the law firm Palmer & Dodge, here representing		
15	BR/Conv. 1-20 (CONFIDENTIAL)	22	9	MCI. With me today is in-house counsel, Laura Gallo.		
16	BR/Conv. 1-26	22	10	CHAIRMAN GETZ: Good morning.		
17	BR/Conv. 1-27	22	11	MS. ROSS: Good morning, Commissioners.		
18	BR/Conv. 1-29	22	12	Anne Ross, with the Office of Consumer Advocate. And, with		
19	BR/Conv. 1-35	22	13	me today is our expert cost of capital witness, Stephen		
20	BR/Conv. 1-38	22	14	Hill.		
21	BR/Conv. 1-39	22	15	CHAIRMAN GETZ: Good morning.		
22	BR/Conv. 1-44	22	16	MS. JACKSON: Good morning. I'm Barclay		
23	BR/Conv. 1-45	22	17	Jackson, representing the staff of the Commission. And, I		
24	BR/Conv. 1-46	22	18	have Chris Schlegel and Kate Bailey, of the Telecom Division		
25	BR/Conv. 1-50	22	19	who are sitting at counsel table.		
26	BR/Conv. 1-52	22	20	CHAIRMAN GETZ: Before we start, I'd		
27	BR/Conv. 1-53	22	21	like to lay out some of our expectations with respect to		
28	BR/Conv. 1-54	22	22	these hearings. We've set four days aside on our schedule		
			23	to hear this case. We'll start each morning at 9:00, and we		
			24	are prepared to go until 6:00 today and until 6:00 on		

Page 113

1 don't remember, that's fine, just tell me that. The
 2 question is, is it fair to say, based on your memory,
 3 that only about 40 percent of the CLEC market share in
 4 New Hampshire, according to the FCC report, comes on
 5 CLEC owned lines, and the other 60 percent is on UNES
 6 or resold lines?
 7 A I don't recall, but the number doesn't sound
 8 unreasonable.
 9 MR. SALINGER: I have no further
 10 questions at this time for this witness.
 11 CHAIRMAN GETZ: Okay. Thank you. I
 12 think this is a good time to take the lunch break. Let's be
 13 back here at 1:35.
 14 (Recess taken at 12:20 p.m. and
 15 reconvened at 1:50 p.m.)
 16 CHAIRMAN GETZ: I understand we're going
 17 to start this afternoon with Mr. Rothschild?
 18 MR. DEL VECCHIO: Yes. Thank you, Mr.
 19 Chairman, for accommodating the change in schedule.
 20 CHAIRMAN GETZ: Thank you. Mr. Macres.
 21 MR. MACRES: Yes. BayRing would like to
 22 call James Rothschild to the stand.
 23 CMSR. BROCKWAY: While Mr. Rothschild is
 24 approaching the stand, I will just note for the record that,

Page 114

1 probably about ten years ago, I hired Mr. Rothschild, when I
 2 was the Independent Conservation and Load Management expert
 3 for Commonwealth Electric, then Commonwealth Electric, in
 4 southeastern Mass. We never had the pleasure of meeting.
 5 Pleasure to meet you. But Mr. Rothschild did some work for
 6 me at that time. I do not imagine that it would have any
 7 impact upon my impartiality here, but I want to note that
 8 for the record in case anyone else did.
 9 (Whereupon James A. Rothschild was duly
 10 sworn and cautioned by the Court
 11 Reporter.)
 12 JAMES A. ROTHSCHILD, SWORN
 13 DIRECT EXAMINATION
 14 BY MR. MACRES:
 15 Q Mr. Rothschild, good afternoon.
 16 A Good afternoon.
 17 Q Please state your full name for the record.
 18 A James A. Rothschild.
 19 Q And, Mr. Rothschild, who engaged you in this proceeding
 20 to submit testimony?
 21 A Both BayRing and Conversent.
 22 Q And, Mr. Rothschild, how are you employed?
 23 A I am a financial consultant specializing in utility
 24 ratemaking.

Page 115

1 Q Are you the same James A. Rothschild whose direct and
 2 rebuttal testimony, dated January 27th, 2003,
 3 proprietary pages of which were filed under seal, and
 4 reply testimony, dated March 11th, 2003, was filed by
 5 BayRing and Conversent with the New Hampshire
 6 Commission on those dates?
 7 A Yes.
 8 Q Is a copy of that testimony before you?
 9 A Yes.
 10 Q Do you have any changes or corrections to this
 11 testimony?
 12 A Yes, I do.
 13 Q Would you please advise us with respect to what changes
 14 and corrections that you have?
 15 A Yes. On Page 2, line 21, the --
 16 Q Of what testimony?
 17 A Oh, this would be of the direct testimony, filed on
 18 January 27th.
 19 Q Okay.
 20 A The "6.93 percent" should change to "6.73 percent".
 21 Q Do you have any other changes?
 22 A Yes, there are several. Just a few more. On Page 25,
 23 line 17, the "9.0" should read "9.5".
 24 Q Okay. Hold on. Okay.

Page 116

1 A Exhibit 2, Page 23, --
 2 CMSR. BROCKWAY: JAR 2?
 3 THE WITNESS: Yes.
 4 MR. MACRES: Yes.
 5 THE WITNESS: This is still part of the
 6 direct testimony.
 7 BY MR. MACRES:
 8 Q JAR Exhibit 2?
 9 A Exhibit 2, and it's Page 23.
 10 Q Okay. JAR Exhibit 2, Page 23.
 11 A Okay. The last sentence on that page that's not in the
 12 footnote, starts "The future constant dividend payout
 13 ratio", that sentence should just be stricken.
 14 Q Do you have any other changes or corrections?
 15 A Yes. On Exhibit JAR 3, Schedule 10, Page 1. The rows
 16 that relate to the portion which says "Based on
 17 Corporate Bonds" has an interest rate on corporate
 18 bonds of "4.78 percent", both in the first column and
 19 in the last column, that's incorrect. It should be
 20 "5.67 percent". And, the arithmetic flows. I could
 21 make every change or just simplify, which I'll do,
 22 unless somebody asks me to be more specific, because I
 23 think the changes are both small and self-evident. The
 24 average on the bottom of the columns change, the first

Page 117

1 column changes from "7.90" to "8.07". The last column
 2 changes from "7.55" to "7.70". This then, which is the
 3 result of the -- one of the risk premium methods, goes
 4 forward to Schedule 2 of Exhibit JAR 3. And, that
 5 changes the average shown from the risk premium CAPM
 6 methods from "7.75" to "8.19", it changes it from
 7 "7.83" to "8.27".
 8 CMSR. BROCKWAY: Could you repeat that?
 9 MR. DEL VECCHIO: Could you repeat that
 10 again.
 11 THE WITNESS: I'm sorry. Yes.
 12 BY MR. MACRES:
 13 Q Now, where are you on that --
 14 A I'm on Schedule JAR Exhibit 3, Schedule 2, towards the
 15 bottom, where it says "average", and, underneath the
 16 word "average", it says "midpoint".
 17 Q Okay.
 18 A Okay. The average as it's on the page is "7.75" to
 19 "8.1" -- I can't see if that's an "8" or a "9", because
 20 I crossed it out, but it should be --
 21 MS. JACKSON: You said "9".
 22 THE WITNESS: Okay.
 23 CMSR. BROCKWAY: It is "8.18".
 24 THE WITNESS: Okay. Thank you.

Page 118

1 CONTINUED BY THE WITNESS:
 2 A And, it should be "7.83" to "8.27", which changes the
 3 midpoint from "7.97" to "8.05". The recommended low
 4 end of the range was 7.97, rounded to 8.00. The "8.05"
 5 I would round the same way. So, there is no change to
 6 any of the conclusions. The only other change I'd like
 7 to discuss, and it's more -- it's really an update,
 8 rather than a change. Is that, when I prepared this
 9 testimony, the most currently available balance sheet
 10 to me from Verizon consolidated -- Verizon
 11 Communications consolidated balance sheet, the most
 12 currently available balance sheet was the balance sheet
 13 as of June 30th, 2002. Since then, the December 31st,
 14 2002 balance sheet is available. And, in that six
 15 month period, Verizon did retire a meaningful amount of
 16 debt, so that the common equity ratio has gone up from
 17 approximately or from the 31.74 percent number that I
 18 had used, to approximately 37 some odd percent. I
 19 think it is appropriate, now that we have had
 20 communication from Verizon management, that they feel
 21 the 37 some odd percent common equity ratio is what
 22 they're using. So, we take that as the best estimate
 23 of what Verizon management feels is appropriate. And,
 24 I therefore would recommend increasing the common

Direct
of
Rothschild
begins
here

Page 119

1 equity ratio. I wonder if -- we do have the updated
 2 schedules, if Mr. Macres would care to hand those out
 3 to people, I would appreciate it.
 4 (Atty. Macres handing documents to the
 5 Commission and all parties.)
 6 CONTINUED BY THE WITNESS:
 7 A The changes that are reflected on this schedule use the
 8 actual consolidated balance sheet of Verizon
 9 Communications as of 12/31/02, it says "03", but it
 10 should be "12/31/02". And, those are the actual
 11 capital structures. I used the same cost of debt as in
 12 my original filed testimony. I lowered the cost of
 13 equity from -- from 10.0 to 9.75, which is consistent
 14 with my original testimony, and then I started out with
 15 the 9.50 cost of equity in my prefiled testimony,
 16 increased that by 50 basis points to reflect the higher
 17 risk associated with the lower common equity ratio that
 18 I used. And, the common equity ratio that has been
 19 updated is still lower than the group average that I
 20 used, but not as much lower. So, therefore, I reduced
 21 the increase from 50 basis points to 25 basis points.
 22 And, that's where I got the 9.75 percent.
 23 CHAIRMAN GETZ: Okay. Before we lose
 24 track of these, Mr. Macres, why don't we mark for

Page 120

1 identification, I guess the first, the witness's
 2 testimonies.
 3 MR. MACRES: Great. I would --
 4 CHAIRMAN GETZ: I'll just go ahead.
 5 MR. MACRES: Okay. Great.
 6 CHAIRMAN GETZ: So, the next number is
 7 Exhibit 37?
 8 MS. MASON: Correct.
 9 CHAIRMAN GETZ: So, why don't we mark as
 10 "Exhibit Number 37" the direct testimony from January 27;
 11 "Exhibit 38" will be the rebuttal testimony from January 27;
 12 "Exhibit 39" will be the reply testimony from March 11; and,
 13 as "Exhibit Number 40", we will mark this single page
 14 revision entitled "Verizon New Hampshire Overall Cost of
 15 Capital JAR Exhibit 3", and that's a revision to an
 16 attachment to Exhibit 37, is that correct?
 17 THE WITNESS: Yes.
 18 (The documents, as described, were
 19 herewith marked as Exhibits 37 through
 20 40, respectively, for identification.)
 21 BY MR. MACRES:
 22 Q Mr. Rothschild, if I were to ask you the same questions
 23 today as they were asked to you in your testimonies,
 24 would your answers be the same?

Page 121

1 A Yes. They would be the same, with the -- to make it
 2 clear, that the numbers that are referenced in my
 3 prefiled direct testimony relate to the June 30th
 4 capital structure. And, I do recommend that the
 5 Commission consider the December 31st capital structure
 6 as more current and therefore more appropriate.
 7 Q Are your answers true and correct to the best of your
 8 knowledge?
 9 A Yes.
 10 Q Do you adopt the testimony as if given from the stand?
 11 A Yes.
 12 Q Mr. Rothschild, at this time, please summarize your
 13 prefiled testimony in a concise manner, as instructed
 14 by the Commissioners and the Chairman earlier today.
 15 A Yes, I will. I will, hopefully, just hit the
 16 highlights. The cost of capital that I am
 17 recommending, overall cost of capital that I am
 18 recommending is 7.20 percent. And, that is based upon
 19 the Verizon consolidated actual capital structure as of
 20 December 31st, 2002. It uses a current estimate of the
 21 cost of debt, rather than an embedded cost of debt, as
 22 traditionally done in utility rate base/rate of return
 23 ratemaking proceedings. And, as I just explained, I am
 24 now recommending a cost of equity of 9.75 percent as

Page 122

1 the one that is consistent with the updated capital
 2 structure.
 3 My recommendation in this
 4 proceeding is and has been worked on to be consistent
 5 with the TELRIC standards, because the TELRIC standard
 6 requires forward-looking. The forward-looking
 7 perspective is not so dramatically different than what
 8 is generally done in a normal rate proceeding. The
 9 cost of equity, in any proceeding I have ever been
 10 involved -- well, I said "any proceeding", I think
 11 there were some times when you went back to see what
 12 happened at a particular date. But, in a normal
 13 ratemaking proceeding, the cost of equity is always
 14 forward-looking. It's not what it was last year, it's
 15 not an embedded cost rate. It's a forward-looking
 16 rate, based upon the Commission's best or the witness's
 17 best estimate of what the investors are demanding on a
 18 forward-looking basis to be willing to put equity
 19 capital at risk.
 20 The purpose, at least when I
 21 recommend a capital structure, is designed to be what
 22 is a reasonable capital structure to finance current
 23 assets on a forward-looking basis. Not what the
 24 Company happened to finance or what might have been an

Page 123

1 appropriate capital structure two years ago or twenty
 2 years. It's what is it on a going forward basis,
 3 recognizing that ratemaking is prospective, and
 4 companies are to be given a reasonable opportunity to
 5 earn a fair return.
 6 The one area that is different, for
 7 sure, is the cost of debt. Traditionally, in a
 8 ratemaking proceeding, the cost of debt is computed on
 9 an embedded basis. So, if a company issued long-term
 10 debt 10 years ago, and it's 30 year debt that is still
 11 outstanding, and, if that debt is not callable or not
 12 economically callable, so it's still out there, even if
 13 it's higher than the current cost of debt, that higher
 14 number is used. And, conversely, if interest rates go
 15 up, and the Company was able to issue debt in an
 16 environment when interest rates were lower, so that the
 17 debt is still outstanding, we still use the embedded
 18 cost of debt. But, I think, for TELRIC, you don't do
 19 that. You're going to use "what happens if somebody
 20 issued new debt today?" And, that's a big difference.
 21 There's another difference that I
 22 discuss in my testimony, and I didn't factor that in,
 23 but it's worth mentioning. If you're always going
 24 forward-looking, if you're always using, in essence,

Page 124

1 replacement cost of asset, you're giving the company
 2 the benefit of an allowance for inflation, and, in
 3 effect, doing it twice. Because what you're -- Because
 4 all capital cost rates already include -- the
 5 traditional text book discussion is "bare rent, plus an
 6 allowance for risk, plus an allowance for inflation",
 7 is in all capital cost rates. And, if you have -- the
 8 allowance for inflation can come from an increment in
 9 prices, or even if you have an item that's going down
 10 in price, it's still the allowance for inflation,
 11 because the higher the inflation rate, the lower the
 12 rate of decline, or the higher the rate of increase,
 13 whatever it is. But that's -- it gets to be -- it was
 14 difficult to do that, make a specific adjustment in a
 15 way that everybody could feel comfortable with, so I
 16 did not make the lowering adjustment for inflation, but
 17 at least I should, I think, and as I point out in my
 18 testimony, give the Commission the thought about that
 19 that is a conceptual difference in what TELRIC perhaps
 20 should consider.
 21 For quantifying the cost of equity,
 22 I used a DCF method, and I used a risk premium/CAPM
 23 method. In the DCF method, and I'm not going to go
 24 through this in detail, because it's explained in my

<p style="text-align: right;">Page 125</p> <p>1 testimony and here for questions. But I use a single 2 stage and a multistage. And, for the -- for risk 3 premium/CAPM, I also used two approaches. One, which 4 was based upon an inflation premium, and the other 5 which was based upon an historic look at what risk 6 premiums have been, in consideration of trends in those 7 ratios.</p> <p>8 A big issue, which I talk about a 9 fair amount in my testimony, and I'm sure it's one that 10 is, well, hopefully is worth a lot of thought, is my 11 recommendation of using a consolidated capital 12 structure, rather than a capital structure -- rather 13 than either a capital structure based on market values 14 or a capital structure based on the capital structure 15 of the subsidiary. The consolidated capital structure 16 I recommended because it's an arm's length transaction, 17 it's the only place we have an actual capital structure 18 where both the debt and the equity is developed arm's 19 length between the outside investors of the Company and 20 Company management. It's the only place where 21 management has an incentive to minimize the overall 22 cost of capital. And, it conservatively reflects how 23 the UNES would be financed today, because management is 24 always managing its capital structure to be where it</p>	<p style="text-align: right;">Page 128</p> <p>1 are setting the market value as an end result. And, 2 so, for that reason, I think that's inappropriate. 3 So, hopefully, that hits the 4 highlights of my testimony, and the differences that I 5 found in my -- when I filed my rebuttal testimony. 6 BY MR. MACRES: 7 Q At this time, Mr. Rothschild, will you please provide 8 any comments you have regarding Verizon's March 11th, 9 2003 rebuttal testimony? 10 A Yes. And, I would appreciate some input guidance from 11 the Commission on this. The testimony, the rebuttal 12 testimony that was filed by Dr. Vander Weide is very 13 lengthy, over 100 pages. I can start out by saying 14 that the points that he made against me, I disagree 15 with all of them. And, I'm happy to respond to all of 16 them. I could go through point-by-point and bore 17 everybody for a couple hours. And, if the Commission 18 so asked me to, I would be happy to do that. Or, I 19 could provide a, hopefully, much briefer summary that 20 hits the highlights, and then leave it open to 21 questions, if there's any areas that the Commission or 22 anybody else feels they would like elaboration on. 23 (Chairman and Commissioners conferring.) 24 CHAIRMAN GETZ: I guess, let me</p>
<p style="text-align: right;">Page 126</p> <p>1 is, always bringing it back in balance, kind of like 2 sailing a boat to a particular compass point. If you 3 get knocked off course, you change where you're 4 steering to to get there. And, it's consistent with 5 what Standard & Poor's views is the appropriate look at 6 things for telecom.</p> <p>7 I've also filed, as part of the 8 same time I filed with my direct testimony, I filed 9 rebuttal testimony. And, there I try to point out the 10 differences between what Dr. Vander Weide has 11 recommended and what I've recommended. There's a huge 12 difference, and the largest difference I've ever seen 13 in a rate proceeding, I think both in absolute basis 14 points or percentage, Dr. Vander Weide is recommending 15 17.93 percent return on capital, versus my 7.20. The 16 differences, just to get them -- the highlights in one 17 spot, hopefully, to help the Commission. He uses 18 market value capital structure, I'm using an actual 19 consolidated. His cost of equity, before adding a 20 leasing premium, is 14.13 percent, versus my 9.75 21 percent. And, then, he adds a leasing premium to the 22 cost of capital, I do not add a leasing premium. 23 As I explained in my prefiled 24 testimony, if you use the capital structures that were</p>	<p style="text-align: right;">Page 129</p> <p>1 characterize it this way, from both directions. The 2 procedural schedule does not provide for surrebuttal. And, 3 to the extent that your responses to Dr. Vander Weide are 4 recounting points you've already made, either in your 5 direct, rebuttal or reply, then we do not need to hear that. 6 If, however, there is something absolutely new that came out 7 in rebuttal, then we would be prepared to hear a short 8 reply. And, it would be the same kind of standards that, 9 from a legal -- from the lawyer's perspective, when, on 10 redirect, it has to be something new that's been brought up 11 for you to respond to it. Is that helpful? 12 THE WITNESS: well, I'm not sure. I 13 mean, for example, I mean, the first point that I have, and 14 to see if this is the kind of response that you're looking 15 for is, in Dr. Vander Weide's rebuttal testimony, he spends 16 a lot of time talking about the risk associated with the UNE 17 investment. And, in so doing, he brings in areas of other 18 investment in telecom that's linked with that. And, there's 19 no place that I've had an opportunity in my other 20 testimonies to respond specifically to that, because I 21 didn't see where he had done that before. But what the kind 22 of clarification that I wanted to make is that, as far as my 23 view is, and what, hopefully, the Commission's view is, that 24 the risk of the UNE investment should be based upon the UNE</p>
<p style="text-align: right;">Page 127</p> <p>1 actual as of the time we filed testimony, if Dr. Vander 2 Weide's recommendation is accepted, the return on 3 equity that would be achieved, on actual book equity 4 achieved, would be 46.9 percent.</p> <p>5 Our DCF differences are he applied 6 his DCF method to the S&P 500; I applied it to 7 telecommunications and other utilities. He truncated 8 the highs and the lows. So, when he took his DCF 9 approach, he said "Ah. Any results that were above 20 10 percent, or below I think it was the A corporate rate, 11 he threw those out. Well, if you do that, if you 12 define a range, you end up forcing your equity costs to 13 close to the midpoint of that range. And, if you have 14 to start rejecting a lot of results, to me, that in and 15 of itself puts a question on what's wrong with the 16 method, "is it really telling you what investors 17 think?"</p> <p>18 For capital structure, he used 19 market value, versus -- on capital structure, as I 20 explain in any testimony, my recommendation is 21 consistent with the Hope case, the standards, which 22 require not to use -- not to set the stock prices as 23 the end result. But, if you're using a market value 24 capital structure and providing a return on that, you</p>	<p style="text-align: right;">Page 130</p> <p>1 investment. And, if it's true that the investments that are 2 made in the non-UNE areas become at risk if business is lost 3 to a UNE customer, that's a separate item. I think that's a 4 large percentage of his rebuttal testimony. It's a big 5 difference. But I haven't had the chance to respond to 6 that. So, it's that kind of point, and, I don't know, a few 7 others like that, that I would like to highlight, if you 8 feel that's appropriate. 9 CHAIRMAN GETZ: well, I guess we would 10 like, on this particular issue, if up could provide some 11 follow-up on that. And, I guess I haven't heard from Mr. 12 Del Vecchio, do you have a position with respect to these 13 additional areas? 14 MR. DEL VECCHIO: I would not object, 15 Mr. Chairman, for the witness to briefly identify areas that 16 the Commission would find helpful. As a general rule, I 17 would not propose we sit here for two hours and allow oral 18 surrebuttal, particularly since the schedule didn't 19 contemplate that, and that would probably mean that we would 20 need to present Dr. Vander Weide with rejoinder testimony to 21 seek to rebut, since we bear the burden of proof. 22 That said, I think the Commission is aware 23 that my view is that, if you have a specific question about 24 something, I would not object to having this witness briefly</p>

Page 131	Page 134
<p>1 discuss it.</p> <p>2 CHAIRMAN GETZ: Okay. Why don't we</p> <p>3 proceed then and play it as we go.</p> <p>4 BY THE WITNESS:</p> <p>5 A Okay. All right. The first point, I basically hit the</p> <p>6 highlights of what I wanted to say, which is the UNE</p> <p>7 investment has been unbundled, and the rates for that</p> <p>8 are, in effect, the purpose of this proceeding. And,</p> <p>9 while it might be true that a -- that, if a customer</p> <p>10 moves from Verizon to a CLEC, or if a customer moves</p> <p>11 from a CLEC back to Verizon, that influences Verizon's</p> <p>12 profit on not only its UNE investment, but its</p> <p>13 investment in other telecommunications equipment. But</p> <p>14 that other telephones equipment is either a competitive</p> <p>15 service or it's a service that you regulate. And, so,</p> <p>16 that, any -- the riskiness of that, whatever it is, I</p> <p>17 don't believe is part of the considerations for this</p> <p>18 proceeding, even though that risk might be very real.</p> <p>19 And, --</p> <p>20 CMSR. BROCKWAY: Mr. Rothschild, I think</p> <p>21 I'm not following you, because I don't have the testimonies</p> <p>22 and the disputes in this case committed to memory yet.</p> <p>23 THE WITNESS: Sure.</p> <p>24 CMSR. BROCKWAY: And, I'm not sure what</p>	<p>1 would like to introduce those data responses as exhibits. I</p> <p>2 have marked them --</p> <p>3 CHAIRMAN GETZ: These are Tabs 32 and --</p> <p>4 MR. MACRES: And 33.</p> <p>5 CHAIRMAN GETZ: -- 33 of your binder?</p> <p>6 MR. MACRES: Yes.</p> <p>7 CHAIRMAN GETZ: Is there any objection?</p> <p>8 MR. DEL VECCHIO: If I can just see, Mr.</p> <p>9 Chairman, what those are again. Tab 32 and Tab 33?</p> <p>10 CHAIRMAN GETZ: Yes. Well, I guess, you</p> <p>11 know, maybe we can do this as well anyway. Since we're only</p> <p>12 marking them for identification, we'll mark them for</p> <p>13 identification, respectively, as Exhibit 42 and 43, and</p> <p>14 you'll have the opportunity, at the end of the proceeding,</p> <p>15 or I guess prior to any actual use by them, to make an</p> <p>16 objection or let us know your position, Mr. Del Vecchio.</p> <p>17 MR. DEL VECCHIO: That's fine.</p> <p>18 (The documents, as described, were</p> <p>19 herewith marked as Exhibits 42 and 43,</p> <p>20 respectively, for identification.)</p> <p>21 MR. MACRES: chairman, BayRing and</p> <p>22 Conversent tenders the witness, Mr. Rothschild, for</p> <p>23 cross-examination. And, we reserve the right to recall him</p> <p>24 to respond to anything new by other witnesses on the stand.</p>
Page 132	Page 135
<p>1 it is that Mr. Vander Weide -- Dr. Vander Weide said to</p> <p>2 which you're replying in this.</p> <p>3 THE WITNESS: Okay. That particular</p> <p>4 point is actually one that comes up over and over and over</p> <p>5 again. Let me see if I can find a quick reference to it.</p> <p>6 (Short pause.)</p> <p>7 CHAIRMAN GETZ: Why don't we try another</p> <p>8 approach.</p> <p>9 THE WITNESS: Okay.</p> <p>10 CHAIRMAN GETZ: I would suggest that we</p> <p>11 can, rather than go through this surrebuttal at this point,</p> <p>12 because we don't know the extent of it, we don't know the</p> <p>13 topics, that we proceed with the cross-examination, and</p> <p>14 then, when we take a break, perhaps, Mr. Macres, you can</p> <p>15 discuss with the other attorneys what these other issues are</p> <p>16 that Mr. Rothschild intends to bring up, and we can get some</p> <p>17 agreement on if they're properly within the scope of issues</p> <p>18 that we should be hearing. And, then, he can collect his</p> <p>19 thoughts on precisely which certain number of points he</p> <p>20 wishes to bring up. Is that acceptable?</p> <p>21 MR. MACRES: Yes, that's acceptable.</p> <p>22 Thank you.</p> <p>23 CHAIRMAN GETZ: Okay. And, then, in</p> <p>24 terms of -- and one procedural issue. There is also two</p>	<p>1 CHAIRMAN GETZ: Okay. Mr. Salinger.</p> <p>2 MR. SALINGER: Thank you, Mr. Chairman.</p> <p>3 CROSS-EXAMINATION</p> <p>4 BY MR. SALINGER:</p> <p>5 Q Mr. Rothschild, in Dr. Vander Weide's rebuttal</p> <p>6 testimony, at Page 56, for example, Dr. Vander Weide</p> <p>7 argues in favor of what he describes a "purely market</p> <p>8 value approach to setting capital structure". And, as</p> <p>9 I understand it, critiques you for not doing so. Dr.</p> <p>10 Vander Weide is of the opinion that financial and</p> <p>11 economic theory requires the use of market value</p> <p>12 weights to calculate the weighted average cost of</p> <p>13 capital. Do you agree with that? And, if not, why</p> <p>14 not?</p> <p>15 A No, I don't agree with that. Market value weights are</p> <p>16 not what management -- it's not the balance sheet, it's</p> <p>17 not where a company goes out and raises capital and</p> <p>18 buys its assets. It's not the decision that's used by</p> <p>19 management when raising capital. I know that Dr.</p> <p>20 Vander Weide talks about -- he mentioned some text</p> <p>21 books, which talk about a market value capital</p> <p>22 structure. And, that market value capital structure in</p> <p>23 the text books that he's referring to are looking not</p> <p>24 from the perspective of the investor. The investor</p>
Page 133	Page 136
<p>1 pages of confidential testimony that were filed under cover</p> <p>2 letter of January 27, with respect to Pages 26 and 27 of the</p> <p>3 direct testimony. Let's mark those for identification as</p> <p>4 Exhibit Number 41.</p> <p>5 (The document, as described, was</p> <p>6 herewith marked as Exhibit 41 for</p> <p>7 identification.)</p> <p>8 MR. MACRES: Thank you, Chairman. And,</p> <p>9 also, that has been marked "proprietary". And, also, what</p> <p>10 we marked as "Exhibit 15" is proprietary. I don't know if</p> <p>11 we want to handle that differently, but I just wanted to</p> <p>12 make sure you were aware of that fact.</p> <p>13 CHAIRMAN GETZ: Yes, and we will treat</p> <p>14 it in confidence.</p> <p>15 MR. MACRES: Okay.</p> <p>16 CHAIRMAN GETZ: The witness is offered</p> <p>17 for cross-examination at this time?</p> <p>18 MR. MACRES: Let me see.</p> <p>19 (Short pause.)</p> <p>20 MR. MACRES: Chairman, I want to make</p> <p>21 one point.</p> <p>22 CHAIRMAN GETZ: Please.</p> <p>23 MR. MACRES: Mr. Rothschild responded to</p> <p>24 1-4 and 1-12 that were propounded on by Verizon. And, we</p>	<p>1 who's going out and making -- who has a decision</p> <p>2 whether or not to buy stock in Verizon or IBM or</p> <p>3 whatever company, and can only do that based upon the</p> <p>4 market price. That's not the same thing, it's not the</p> <p>5 same perspective as the capital budgeting process, the</p> <p>6 process that's gone through when company management is</p> <p>7 deciding how to finance assets, be they TELRIC assets</p> <p>8 or any other assets.</p> <p>9 MR. DEL VECCHIO: If I could, Mr.</p> <p>10 Chairman, just to interject. And, I apologize for the</p> <p>11 interruption. But I think that answer was information</p> <p>12 already set forth in Mr. Rothschild's direct and/or rebuttal</p> <p>13 testimony. I don't think it rises to the level of the</p> <p>14 threshold that the Chair had identified for new information.</p> <p>15 And, if these are going to be a series of friendly cross</p> <p>16 questions that are simply seeking to highlight information</p> <p>17 that is already contained in Mr. Rothschild's testimony,</p> <p>18 then I would submit that the Chair's admonition would apply,</p> <p>19 which is "perhaps we should move on".</p> <p>20 MR. SALINGER: Well, if I could respond</p> <p>21 briefly to the interruption. The Chair's "admonition", to</p> <p>22 use Mr. Del Vecchio's word, was describing the properly</p> <p>23 limited scope of surrebuttal by the witness. This is</p> <p>24 cross-examination. I'm cross-examining this witness on</p>